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E.O. 12958: N/A
TAGS: EAID ECON EFIN UG
SUBJECT: UGANDA -- GLOBAL FINANCIAL CRISIS: RESPONSE TO REQUEST

REF: A) 2008 SECSTATE 134905 B) 2008 KAMPALA 1383

¶1. SUMMARY: The following are question-by-question responses to the request for information outlined in reftel. As a result of the global financial crisis, the Government of Uganda (GOU) has adjusted down its estimated economic growth rate by roughly two percentage points for the 2008/2009 fiscal year. Officials stated GOU statistics are not yet available on the impact on exports, remittances or increased unemployment, but stated they expect the economy to grow by between 7% and 7.5%, down from the 9% expected earlier. The real impacts will be seen in the second and third quarters of 2009, they state. As reported in ref B, the domestic economy is vulnerable to reduced flows of donor assistance, remittances, and foreign direct investment. It will also be hit by lower prices and demand for critical exports such as coffee, along with higher interest rates. On the upside, Uganda's financial sector is generally well insulated from the international financial crisis because domestic banks have little exposure to international markets and the GOU has kept debt ratios low. END SUMMARY.

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General Real Economy Impact
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¶2. Do you see evidence that economic activity in key sectors is slowing down as a result of the crisis?

-- Econoff interviewed Dr. David Kihangire, Acting Executive Director of Research at the Bank of Uganda and Mike Olupot-Tukei, Assistant Commissioner of the Macroeconomic Policy Department at the Ministry of Finance, Planning and Economic Development. Both officials say the crisis has not yet had any measurable impacts on key sectors. They expect an impact on the construction industry, which benefits from roughly $1 billion in remittances per year, but have not seen any effects thus far. Key agricultural products are also likely to see reduced demand, including coffee, fish, cut flowers, and cotton.

¶3. Do you see evidence of rising formal sector unemployment or reduced household incomes? Are government social safety net programs up to the job of addressing any increase in poverty or food insecurity caused by the financial crisis?

-- Formal sector unemployment has not increased, according to Olupot-Tukei. While a rise in formal sector unemployment is possible, 80% of Ugandans employ themselves through the agriculture and fishing industries. Most Ugandans mitigate the effects of unemployment through reliance on subsistence agriculture and the informal economic sector. Overall unemployment remains low, at about 3%, but most Ugandans avoid unemployment by turning to subsistence agriculture in the event they cannot find employment. The GOU has been pressed to create formal sector employment at the rate of population growth, which stands at 3.2%. Social safety net programs are generally inadequate.

¶4. Is the government amenable to taking necessary actions to respond

to the crisis? Is the crisis creating political challenges or unrest that is making it more difficult for authorities to take needed policy measures?

-- GOU officials at both the Finance Ministry and Bank of Uganda (BOU, or Central Bank) said the Government has not made any adjustments to policy at this time, but is closely observing the effects of the crisis. Officials appear amenable to spending funds from Uganda's Central Bank reserves, which currently stand at $2.7 billion, or 5.2 months of export cover, to compensate for certain shortfalls in government revenue or donor funding.

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Impact on Trade and Investment
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¶5. Have you seen evidence of a slowdown in foreign demand for the host country's principal export commodities? Have imports of critical inputs to production (e.g., fuel and other raw materials, fertilizer, etc.) slowed down?

-- Ugandan officials have seen no impacts thus far on trade. It must be stated that Uganda's statistics are typically released with a several month delay. Officials expect key exports, including coffee, fish and cut flowers, to suffer, but officials state they will only see these impacts in late 2009 and that impacts depend on the severity of the global recession.

-- A drop in commodity prices has increased tension among some farmers. The GOU recently intervened in negotiations between the

Ugandan Cotton Development Organization and farmers to force the group to purchase the crop at a higher price. According to Citibank Uganda, the decline in commodities prices is having an impact on the domestic steel industry, as leading steel companies are now holding inventory purchased at higher prices and will have to sell at a loss. Demand for cement has fallen "marginally," according to Citibank. The Ugandan Coffee Manufacturers Association told the press that the drop in coffee prices from $2,400 per ton to $1,700 in November was also a cause for concern.

¶6. Are major exporters and importers able to obtain letters of credit and other trade finance? Has the cost of trade-related services (e.g., credit, insurance, shipping) increased?

-- Bank executives reported that exporters and importers are able to obtain credit, though interest rates have risen. The base rate for 12-month Ugandan-shilling loan for prime borrowers stands at 18%. The rate for Ugandan government 12-month treasury bills currently stands at 18.5%, up from just 14% in July 2008. The costs of trade-related services have increased, but mainly because the price in diesel and gasoline fuel in Uganda has risen. Fuel price increases are a result of supply constraints stemming from a new Kenyan law limiting the size of fuel trucks traveling on the roads and maintenance on the pipeline to Uganda from Kenya. The vast majority of Uganda's fuel imports come through Kenya.

¶7. Is your host country's economy heavily dependent on remittances from its nationals working abroad? If so, do recent data or anecdotal information suggest any significant changes?

-- Uganda receives roughly $1 billion per year in remittances from Ugandan workers abroad, about three times the value of Uganda's coffee exports, the country's largest revenue earner outside of donor assistance. The Central Bank confirms that remittances have fallen, though it could not provide a figure. According to the Eastern Africa Association, a business advocacy group based in Nairobi, some foreign exchange bureaus have reported a 30% drop in remittance transfers.

¶8. Are you aware of major planned foreign direct investment (FDI) projects that have been delayed or cancelled due to the financial crisis?

-- Oil exploration firms in western Uganda have invested some $500 million in oil exploration in Uganda. These companies confirmed that the tightening of credit markets would force them to delay some planned exploration this year, though they hesitated to quantify the

length of potential delays.

-- Norpak, a Norwegian power firm, announced in late 2008 that negotiations on its investment in the 150-megawatt Karuma Falls hydroelectric dam had broken down with the GOU. Karuma Falls is second largest power plant planned in the GOU's power development plan, after the Bujagali dam, which is due for completion in January ¶2011. Though Norpak's withdrawal was not a direct result of the financial crisis, the current global financial crisis could complicate the GOU's ability to find an alternative investor.

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Financial Sector Impacts
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¶9. Is there evidence that firms are finding it more difficult or more expensive to borrow? Do you see impacts of reduced credit availability in the real economy, such as deferred capital investments or firms shutting down?

-- Citibank Managing Director Shirish Bhide told Econoff that liquidity exists for short-term (12-month) borrowers. Domestic banks, largely unexposed to global markets, will remain capitalized. However, investors needing term loans of longer than one year are finding higher rates and less liquidity in the market. Bhide said that the local market urgently needed export credit agencies such as the U.S. Export-Import bank to increase their operations in Uganda.

¶10. Are bankers concerned that nonperforming loans are rising as a proportion of their overall loan portfolios?

-- The Ministry of Finance reported that the rate of non-performing loans for Ugandan commercial banks for 2008 stood at 6.5%, compared to 4.5% the previous year. The increase in non-performing loans as not directly linked to the credit crisis, however, the Ministry stated.

¶11. Do you feel confident that bank regulation in your country is strong enough to deal with the challenges of a potentially weakened financial system?

-- Ugandan bank regulation is among the strongest in sub-Saharan Africa, domestic banks are well capitalized, and confidence in the formal banking sector is high. Currently, Ugandan banks rely almost completely upon local assets for their local lending practices and are known to be extremely conservative. The mortgage market is still in its infancy, as is the Ugandan Stock Exchange. Central Bank officials told Econoff that Ugandan banks had almost no exposure to "toxic" assets abroad, such as real estate securities that could destabilize the sector.

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Impacts on Government Revenues and Expenditures
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¶12. Are you aware of any recent plans by the government to curtail investment or other important government spending?

-- As mentioned above, the GOU's planned construction of Karuma Falls hydroelectric dam currently remains in doubt because a key investor withdrew. The GOU had allocated $70 million in the 2008/2009 fiscal year for the construction, but it remains unclear from where the remainder of the necessary financing will come.

-- Construction of the 250 MW Bujagali Dam, already under construction, will move forward. The World Bank has provided a guarantee for the project and included a $20 million contingency fund for interest rate fluctuations which can be employed, according to Kampala-based World Bank officials.

¶13. Are overall public sector revenues in the country highly dependent on import tariffs, taxes on commodities, or other taxes whose yields may decline as a result of the economic crisis?

Public revenues are expected to decline for a broad number of reasons. GOU revenues from a wide range of tariffs will fall due to lower growth.

¶14. Is there any indication that other funding sources for the government's budget (other donor flows, commercial loans, sovereign bonds) may fail to materialize due to the crisis?

Central Bank officials announced on January 14 that due to the global financial crisis the GOU would not issue its first Eurobond to fund infrastructure projects.

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Other Donor and Multilateral Institutions, Plans
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¶15. Have the in-country representatives of the IMF, World Bank, and other significant bilateral or multilateral donors entered into discussion with the host country government or non-governmental organizations regarding additional or accelerated assistance in response.

No.

¶16. What issues have multilateral or other donors identified in connection with this crisis as significant problems or weaknesses to be addressed in your country? If they have proposed new assistance, have the details been announced or reported in other channels?

-- IMF Representative Abebe Selassie noted that financing will be extremely expensive for road and power developments and will put increasing pressure on future budgets. The GOU had committed itself to spending some $200 million per fiscal year from the reserves on roads and power infrastructure. Falling exports, however, will result in lower foreign currency earnings, putting pressure on Uganda's reserves over time. Poor revenue performance would also reduce the GOU's ability to fund a range of projects through the budget and would dampen economic growth, he said. Still, Selassie praised the GOU for not spending a significant amount of the reserves to support the Ugandan shilling, which has weakened by some 25% in the last six months. "Good credit to them (GOU) for them taking it on the chin," he said.

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